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No.

In The

Supreme Court of the United States

October Term, 1991

ARNOLD HOCHSTEIN,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED

Under Section 6672 (a) of the Internal Revenue Code (United States Code, Title 26), individuals responsible for collecting and paying a corporation's federal employment taxes who willfully fail to do so may be personally liable therefor.

1. Did the United States Court of Appeals for the Second Circuit, which by a 2-1 decision reversed the findings of the District Court after trial, correctly conclude that Mr. Hochstein was liable under Section 6672(a)?

2. Did the Second Circuit correctly conclude that the Government presented adequate proof of a January 5, 1987 assessment within the requirements of Treasury Regulation Section 301.6203-1, even though no document dated prior to May 3, 1989 was offered by the Government as proof of the alleged assessment?

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No. _____

In The

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October Term, 1991

ARNOLD HOCHSTEIN,

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Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The petitioner, Arnold Hochstein, respectfully prays that a writ of certiorari issue to review the opinion and order of the United States Court of Appeals for the Second Circuit reported at 900 F.2d 543 (2d Cir. 1990), and the opinion and order of the United States Court of Appeals for the Second Circuit in this action entered on the docket on December 19, 1991.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit, dated April 3, 1990 is reported at 900 F.2d 543, and appears in the Appendix at 1a.

The opinion of the United States District Court for the Southern District of New York, dated May 26, 1989, is reported at 713 F. Supp. 119, and appears in the Appendix at 42a.

The order of the United States Court of Appeals for the Second Circuit, entered on the docket on December 19, 1991, is not reported and appears in the Appendix at 20a.

The opinion of the United States District Court for the Southern District of New York, dated April 23, 1991 is not reported and appears in the Appendix at 25a.

The report and recommendation of Magistrate James C. Francis IV, dated February 19, 1991 is not reported and appears in the Appendix at 31a.

STATEMENT OF JURISDICTION

Petitioner Arnold Hochstein commenced this action under 28 U.S.C. § 1346(a)(1) seeking a refund and abatement of a "100 percent penalty" assessed against him by the Internal Revenue Service pursuant to § 6672 of the Internal Revenue Code (United States Code, Title 26). The Government counterclaimed for the unpaid balance of the assessment.

After trial in the United States District Court for the Southern District of New York, before Hon. Peter K. Leisure, a decision was rendered in favor of petitioner as to all issues tried. The Government appealed.

The United States Court of Appeals for the Second Circuit reversed the determination by the trial court by a 2-1 decision. That court vacated the District Court's judgment and remanded the case to the District Court with instructions to enter judgment in favor of the Government on its counterclaim. No amount was specified by the Second Circuit.

Upon remand, the parties contested the amount of the judgment to be entered in favor of the Government; petitioner contended that the Government's proof at trial of the alleged assessment did not comply with Treasury Regulation § 301.6203-1. The District Court directed that the matter be heard by Magistrate James C. Francis IV, and that a report and recommendation be made to the District Court.

By order dated April 23, 1991, the District Court, adopting the recommendation of the Magistrate, rejected petitioner's position, resulting in judgment in favor of the Government in the amount of $45,319.29.

The jurisdiction of this Court to review the orders of the Second Circuit Court of Appeals lies under 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

The following statutes are involved in this proceeding:

26 U.S.C. § 6672(a):

> Section 6672. Failure to collect and pay over tax, or attempt to evade or defeat tax.
>
> (a) Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or

> truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat such tax or the payment thereof, shall in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable.

Section 198-a Labor Law of New York:

> Every employer who does not pay wages of all of his employees in accordance with the provisions of this chapter is, and the officers and agents of any corporation who knowingly permit the corporation to violate this chapter by failing to pay the wages of any of its employees in accordance with the provisions thereof, are guilty of a misdemeanor, and upon conviction therefor, shall be fined not less than one hundred nor more than ten thousand dollars or imprisoned for not more than one year, or punished by both such fine and imprisonment, for each such offense. An indictment of a person or corporation operating a steam surface railroad for an offense specified in this section may be found and tried in any county within the state in which such railroad ran at the time of such offense.

Treasury Regulation Section 301.6203-1:

> § 301.6203-1. Method of assessment. — The district director and the director of the regional

service center shall appoint one or more assessment officers. The district director shall also appoint assessment officers in a Service Center servicing his district. The assessment shall be made by an assessment officer signing the summary record of assessment. The summary record, through supporting records, shall provide identification of the taxpayer, the character of the liability assessed, the taxable period, if applicable, and the amount of the assessment. The amount of the assessment shall, in the case of tax shown on a return by the taxpayer, be the amount so shown, and in all other cases the amount of the assessment shall be the amount shown on the supporting list or record. The date of the assessment is the date the summary record is signed by an assessment officer. If the taxpayer requests a copy of the record of assessment, he shall be furnished a copy of the pertinent parts of the assessment which set forth the name of the taxpayer, the date of assessment, the character of the liability assessed, the taxable period, if applicable, and the amounts assessed.

STATEMENT OF THE CASE

Safelon Corporation ("Safelon"), was a plastic bag manufacturer in Yonkers, New York. Its president was Ernest Eckstein ("Eckstein"). For 18 years prior to the liquidation of Safelon, petitioner Arnold Hochstein served as its controlier. With a brief interruption in 1971, when Safelon filed a voluntary Petition in Bankruptcy, in part because it was unable to pay its federal employment taxes, the employment taxes of Safelon were timely paid. Safelon emerged from bankruptcy and all taxes were paid in full.

In 1979, Safelon's president, Ernest Eckstein, without

consultation with petitioner, entered into a factoring agreement with Rosenthal & Rosenthal ("Rosenthal"), a commercial finance company. Pursuant to the factoring agreement with Rosenthal, which petitioner was instructed by Eckstein to comply with, all operating funds of Safelon were contractually controlled by Rosenthal. Under the factoring agreement, any funds received by Safelon, from any source, had to be turned over to Rosenthal.

Because of Safelon's agreement with Rosenthal, Hochstein communicated with Rosenthal frequently, and would inform Rosenthal as to which obligations of Safelon were coming due. Rosenthal would then make a determination as to which funds would be issued, and would issue those funds to Safelon.

From 1979 through the third week of January, 1981, Hochstein periodically requested from Rosenthal funds to pay, among other things, wages and federal employment taxes. Rosenthal furnished such funds. In the third week of January, 1981, however, Rosenthal decided that Safelon should be liquidated. Petitioner, who had nothing to do with any employment or other operating decisions of Safelon, was told about the liquidation and began his search for other employment, while working reduced hours at Safelon.

Rosenthal's decision to liquidate caused the electricity to the plant to be shut off as of the first week of February, 1991, because no funds were provided by Rosenthal to pay the electric bill. The liquidation sale took place in mid-March, 1981.

During the period in question, petitioner requested from Rosenthal funds to pay both the earned wages of the remaining employees and corresponding federal employment taxes. Rosenthal, for the first time, refused to provide any funds for the payment of taxes, and provided only funds to pay earned

wages of the employees. It was not disputed, and the trial court found, that petitioner expressly requested funds to pay the subject taxes. After completing the last quarterly tax return for Safelon, petitioner left the company.

There was no claim made by the Government that petitioner failed to account properly to the Government with respect to the taxes, and there was no claim that Safelon or petitioner had, during the subject period, ever collected funds from Rosenthal to pay the employment taxes. Rosenthal, on the other hand, received more than $800,000 upon the liquidation of Safelon's assets.

Although the Government threatened to issue an assessment against Rosenthal, it did not do so prior to the expiration of the applicable statute of limitations. Similarly, the Government never issued an assessment against Mr. Eckstein, Safelon's President during all relevant times. Petitioner, unlike Mr. Eckstein, was not a shareholder of Safelon, and had nothing to do with its operational decision-making, such as the decision to hire employees, reduce staff, pay debts, or borrow funds.

The District Court, after trial, found that petitioner was not a "responsible person" within the meaning of cases interpreting § 6672, and further that any failure on petitioner's part was not "willfull" within the meaning of that provision. The District Court granted petitioner all relief requested in the complaint.

On appeal to the Second Circuit Court of Appeals, the District Court's judgment was vacated. Over a vigorous dissent, the Second Circuit reversed the District Court's determination both as to the question of whether petitioner was a "responsible person" and as to whether petitioner willfully failed to pay the subject taxes. The Second Circuit apparently accepted the fact that the only funds available to Safelon during the period in question were funds obtained from Rosenthal, and further accepted the fact that the

funds given were not sufficient to pay both earned wages and employment taxes. The Second Circuit "appreciate[d] the difficult situation in which Mr. Hochstein found himself" but concluded that petitioner, on his own, should have prorated the last funds received from Rosenthal and paid the employees less in order to pay federal employment taxes. The Second Circuit so held in spite of § 198-a of the Labor Law of New York which imposes serious criminal penalties for failure to pay earned wages to an employee.

The majority disagreed with the dissent as to the level of petitioner's responsibilities, and as to the effect of the state statute.

The Second Circuit vacated the District Court judgment and remanded the case to the District Court with instructions to enter judgment on the Government's counterclaim.

On remand, the parties disagreed as to the proper amount of a judgment. At trial, a Government witness called for the exclusive purpose of testifying as to the amount of tax due stated, on May 8, 1989, that the "current status" of the indebtedness, including principal and interest, was $31,577.51. Petitioner accepted that figure, and further allowed for interest accruing thereafter, that is, following the date of trial. The Government submitted a judgment inconsistent with the testimony of its own witness. The court referred the dispute to a Magistrate for a plenary hearing.

At the hearing, as at trial, the only proof of an assessment relied on by the Government was a document dated May 3, 1989. Petitioner submits that, under Treasury Regulation § 301.6203-1, if that document constitutes proof of the assessment, then the Government's claim is limited to the sum of $31,577.521 plus interest at the statutory rate from the date *of that document.*

The District Court accepted the Government's position on

this issue. By order entered on the docket on December 19, 1991, the Second Circuit Court of Appeals affirmed the District Court's determination as to the amount of the judgment.

Petitioner, pursuant to 28 U.S.C. 1254(1), seeks review of the two adverse determinations of the Second Circuit Court of Appeals.

REASONS FOR GRANTING THE WRIT

This case not only presents issues as to the interpretation of taxing statutes, which necessarily affect the public at large, but does so in an economic atmosphere of record business failures and bankruptcies.

The Second Circuit's decision radically alters existing standards of liability under § 6672. One district judge who carefully considered the situtation confronting petitioner concluded that "the majority in *Hochstein* gave short shrift to the realities of the situation, Cf. *Slodov v. United States,* 436 U.S. at 254. . . . " *United States v. Vaccarella,* 735 F. Supp. 1421, 1430 (S.D. Ind. 1990).

The majority did indeed ignore this Court's holding in *Slodov v. United States,* 436 U.S. 238 (1978), which makes it clear that § 6672 "was not intended to impose liability without personal fault." 436 U.S. at 254. The majority did not even refer to *Slodov.*

The Second Circuit's decision is well outside established precedent interpreting the statute, and, as stated, one court has gone so far as to refuse to follow it:

> The court acknowledges the Second Circuit's recent decision holding a company treasurer liable under § 6672 in analogous circumstances. See *Hochstein*

> *v. United States*, 900 F. 2d 543 (2nd Cir. 1990). In certain respects, that case can be distinguished on the facts, but even if not distinguishable on that basis, and with all due respect, this court declines to follow that decision, finding Judge Newman's dissent the more persuasive treatment of those facts and the applicable law. In focusing on the treasurer's physical ability to re-direct payments from a lender, the majority in *Hochstein* gave short shrift to the realities of the situation, *Cf. Slodov v. United States*, 436 U.S. at 254, 98 S.Ct. at 1788, and in effect held the treasurer liable because, hypothetically, he could have exercised some control over the disbursal decisions.

The situation which has emerged is that whether individuals can be held liable for potentially massive, non-dischargeable obligations of their former corporate employers is dependent upon geographic fortuities. The large volume of § 6672 cases does not permit courts to review comprehensively applicable authority, and grossly disparate results obtain.

In *Feist v. United States*, 607 F. 2d 954 (Ct. Cl. 1979), the court, applying this Court's standards in *Slodov*, concluded that an individual was not liable under § 6672 even though some $50,000 to $60,000 was available in store cash registers to pay employment taxes. The court held that it would have been a complete disregard of business reality to interrupt store operations to collect funds available in the stores' cash registers.

In contrast, under the Second Circuit's decision, petitioner was required to disregard the instructions of his superior; breach a valid factoring agreement entered into by his corporate employer; obtain money from a lender under false pretenses; and risk the commission of, if not commit, a crime under applicable state law

punishable by a fine of up to $10,000 and imprisonment for up to one year, for each employee not paid in full.

Of the five federal judges who have looked closely at the facts of *Hochstein*, three have concluded, and in no uncertain terms, that petitioner is not liable for the employment taxes of his former employer. In his dissent in *Hochstein*, Judge Newman correctly concluded that the trial court's decision was entirely consistent with applicable law.

Petitioner submits that, nationwide, this Court's guidance in *Slodov* has been eroded, and the standard of liability under § 6672 ranges from one of virtually strict liability, where possession of a checkbook is the critical inquiry, to extreme leniency, where the mere inconvenience of taking money out of cash registers has excused liability. Further, as reflected by the *Vaccarella* case, *supra*, these divergent standards are not being reconciled; it is not possible to do so.

This Court's review of the Second Circuit's decision is warranted, and in view of the present economic climate, desparately needed.

Finally, the second issue in this case is similarly deserving of Supreme Court review, as it affects every single assessment issued pursuant to § 6672. Under Treasury Regulation § 301.6203-1, and applicable case law, the Government may prove a valid assessment by introducing at trial a summary record of assessment made by an assessment officer. Under that regulation: "The date of the assessment is the date the summary record is signed by an assessment officer."

Under the Second Circuit's decision, the Government, in order to meet its burden of proof on a counterclaim seeking payment of an assessment, need only generate at any time, including on

the day of trial, a computer run allegedly constituing a record of assessment, and have that document signed by an assessment officer. Such was the case here where the alleged record of assessment was dated May 3, 1989, a few days before trial. To be clear, both the certificate of the assessment officer and the underlying document were dated a few days before trial. No proof was offered that an earlier assessment had been made.

Despite the relevant Treasury Regulation which provides that if a summary record of assessment is used, "the date of the assessment is the date the summary record is signed by an assessment officer," in this case the courts permitted the Government to recover interest on the alleged assessment from January 5, 1987, years before the date the summary record of assessment was signed by the assessment officer. The effect of this holding is to permit the Government to issue no assessment until trial, then to generate by computer a current document, but collect interest from whatever date the Government may choose to input.

It is well settled that the introduction of an assessment is the only required element of the Government's proof. *See, e.g., Brafman v. United States,* 384 F.2d 863 (5th Cir. 1967). By requiring no contemporaneous proof of an assessment, the Second Circuit has completely undermined a variety of procedural protections afforded taxpayers, not the least of which is a statute of limitations.

As stated, the issue of the required documentary proof of an assessment necessarily affects every taxpayer, and is worthy of Supreme Court review.

CONCLUSION

Petitioner respectfully prays that his petition for a writ of certiorari be granted.

Respectfully submitted,

RALPH COTI
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Attorneys for Petitioner

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DATED APRIL 3, 1990

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 625—August Term, 1989

(Argued January 12, 1990 Decided April 3, 1990)

Docket No. 89-6190

ARNOLD HOCHSTEIN,

Plaintiff-Appellee,
Counterclaim Defendant,

—v.—

UNITED STATES OF AMERICA,

Defendant-Appellant,
Counterclaim Plaintiff.

Before:

KAUFMAN, MESKILL and NEWMAN,
Circuit Judges.

Appeal from a judgment entered in the United States District Court for the Southern District of New York, Leisure, *J.*, after a trial before the court. The court held that plaintiff Hochstein was not liable for taxes assessed

against him pursuant to 26 U.S.C. § 6672 because he was not a person responsible for the collection and payment of his former employer's withholding and social security taxes, and because his failure to pay the taxes was not willful, as required for personal liability under the statute.

Vacated and remanded. Judge Newman dissents in a separate opinion.

CRAIG A. STEWART, Assistant United States Attorney, Southern District of New York, New York City (Otto G. Obermaier, United States Attorney for the Southern District of New York, Nancy Kilson, James L. Garrity, Jr., Assistant United States Attorneys, Southern District of New York, New York City, of counsel), *for Appellant*.

STEPHEN R. SUGRUE, New York City (Lowenthal, Landau, Fischer & Ziegler, New York City, of counsel), *for Appellee*.

MESKILL, *Circuit Judge*:

In this appeal we consider the circumstances under which an individual may be held personally liable pursuant to 26 U.S.C. § 6672 for withholding and Federal Insurance Contributions Act (FICA) tax payments that his former employer failed to make. Pursuant to section

6672, the Internal Revenue Service (IRS) assessed against plaintiff Hochstein a penalty equivalent to the amount of withholding and FICA taxes unpaid by his former employer, the Safelon Corporation (Safelon), for the first two quarters of 1981. Hochstein made partial payment and brought this action seeking a refund of the amount paid, an abatement of the unpaid assessment and an injunction prohibiting further collection efforts. The IRS counterclaimed for the balance of the unpaid assessment. After a two day trial before the United States District Court for the Southern District of New York, Leisure, *J.*, the court denied the government's counterclaim and rendered judgment in favor of Hochstein. The government appeals.

Because we conclude that Hochstein was a person responsible for the collection and payment of Safelon's withholding taxes within the meaning of section 6672, and that his failure to comply with the statute was willful, we vacate the district court's judgment and remand with instructions to dismiss the complaint and enter judgment in favor of the government on its counterclaim.

BACKGROUND

The district court's factfinding is largely undisputed on appeal. The following is a brief summary of those facts essential to our disposition of this case. The district court's opinion, which sets forth the background in some detail, is reported at 713 F.Supp. 119 (S.D.N.Y. 1989).

From 1963 to May 1981, Hochstein was the controller of Safelon, a manufacturing business located in West-

chester County, New York. Hochstein was never a shareholder, director or officer of Safelon. As controller, Hochstein was responsible for overseeing the finances of the corporation, including the preparation of the payroll and the filing of Safelon's payroll tax returns. During the tax period in question, Hochstein and Ernest Eckstein, the President and majority shareholder of Safelon, were the only two individuals authorized to sign checks on behalf of Safelon.

Safelon experienced severe financial problems beginning in the early 1970s. Due to its poor financial condition, Safelon entered into a financing agreement (the Agreement) with the firm of Rosenthal & Rosenthal (Rosenthal) in 1979. Under the Agreement, Rosenthal supplied operating funds to Safelon in return for a security interest in Safelon's accounts receivable and physical assets. Although Hochstein had no input into Safelon's decision to enter into the Agreement, he was the primary person who dealt with Rosenthal on behalf of Safelon once the Agreement was in place.

Pursuant to the Agreement, Hochstein would request that Rosenthal advance funds to Safelon, indicating the purpose for which he was requesting them. Rosenthal decided whether or not to grant Hochstein's requests based on a formula contained in the Agreement. Rosenthal did not earmark any specific purposes for the funds advanced and did not control the actual use to which the funds were put once they were given to Safelon. The indebtedness created by these advances was reduced by Safelon's accounts receivable: Safelon forwarded all checks and cash that it received directly to Rosenthal. The net effect of this arrangement was that Safelon's only operating funds were those that Rosenthal chose to

provide. Nevertheless, the Agreement provided that Safelon remained responsible for making all tax payments.

In January 1981, Safelon's financial condition worsened, and Rosenthal refused to fund continuing operations. Safelon was forced to reduce its workforce to a skeleton staff, and operated only to convert the raw materials that remained in inventory into finished product. In the process, Safelon became heavily indebted to Rosenthal. As a result, Rosenthal decided to liquidate Safelon's physical assets. Thereafter, Hochstein was provided with sharply reduced funds, sufficient only to pay for the bare essentials during the liquidation process; for example, oil for a generator, gasoline for delivery trucks, and net payroll for the remaining employees, including Hochstein. Most creditors went unpaid.

Safelon ceased making the withholding and FICA tax payments from its employees' wages in the fourth week of January 1981. After that point, Hochstein requested that Rosenthal provide funds for the taxes, but Rosenthal gave Hochstein only enough money to cover net wages. Hochstein paid these net wages to the remaining employees until he left Safelon in May 1981. He also signed and filed Safelon's payroll tax return for the first quarter of 1981. This return indicates that Safelon remitted payment only for the first three weeks of the quarter.

Safelon's physical assets were liquidated some time during the spring of 1981, and the proceeds were used to reduce Safelon's debt to Rosenthal. Safelon ceased operations altogether in the second week of May 1981.

Pursuant to section 6672, the IRS assessed against Hochstein a penalty equivalent to the unpaid withhold-

ing and FICA taxes. Hochstein made partial payment and commenced this action seeking recovery of the amount paid, an abatement of the unpaid portion of the assessment, and an injunction prohibiting the IRS from taking further steps to collect the tax from him. The IRS counterclaimed for the balance of the unpaid assessment, totalling $31,577.51 plus interest.

The district court held that Hochstein was not a person responsible for collecting and paying Safelon's withholding taxes within the meaning of section 6672, and that even if he was responsible, Hochstein incurred no personal liability because he did not willfully fail to make the tax payments.

DISCUSSION

Section 6672 provides, in pertinent part:

> Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall . . . be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

26 U.S.C. § 6672(a). It is well established that the statute requires two elements to be present before personal liability for unpaid withholding taxes attaches: first, the individual must be a person responsible for the collection and payment of withholding taxes, *i.e.*, he must have the authority to direct the payment of corporate funds; second, the individual's failure to comply with

the statute must be willful. *See, e.g., Caterino* v. *United States*, 794 F.2d 1, 3 (1st Cir. 1986), *cert. denied*, 480 U.S. 905 (1987); *Teel* v. *United States*, 529 F.2d 903, 905 (9th Cir. 1976); *Werner* v. *United States*, 374 F.Supp. 558, 560 (D. Conn. 1974), *aff'd on opinion below*, 512 F.2d 1381 (2d Cir. 1975). The individual against whom the assessment is made bears the burden of proving by a preponderance of the evidence that one or both of these elements is not present. *See, e.g., Calderone* v. *United States*, 799 F.2d 254, 258 (6th Cir. 1986); *Lesser* v. *United States*, 368 F.2d 306, 310 (2d Cir. 1966) (in banc). Hochstein failed to meet this burden.

A. *Responsibility*

1. *Standard of Review*

The preliminary question is by what standard we should review the district court's findings and conclusion on the issue of Hochstein's responsibility for the payment of Safelon's taxes. Most courts that have addressed the issue of the proper scope of review have treated the question of responsibility as a factual finding that may not be set aside unless clearly erroneous. *See Gustin* v. *United States*, 876 F.2d 485, 491 (5th Cir. 1989); *Caterino*, 794 F.2d at 3, 5; *Maggy* v. *United States*, 560 F.2d 1372, 1375 (9th Cir. 1977), *cert. denied*, 439 U.S. 821 (1978). This approach is facially appealing because, as discussed below, whether an individual is responsible for the payment of a corporation's withholding taxes depends primarily on the factual question of the degree of control he exercises over the corporation's finances. Nevertheless, we believe that the issue whether a person is responsible within the meaning of section

6672 presents a mixed question of fact and law. *See Thibodeau* v. *United States*, 828 F.2d 1499, 1503 (11th Cir. 1987) (deciding question of responsibility as question of law when facts undisputed). Therefore, we will review the district court's findings on Hochstein's control over Safelon's finances only for clear error, and give plenary review to its conclusion that this control did not make him responsible within the meaning of the statute. *Cf. Puma Indus. Consulting, Inc.* v. *Daal Assocs., Inc.*, 808 F.2d 982, 986 (2d Cir. 1987) ("When a conclusion represents a mixed question of law and fact, . . . that conclusion is open to full review.").

2. *The Merits*

The government argues that, in determining that Hochstein was not a person responsible for the payment of Safelon's withholding taxes, the district court incorrectly focused on Hochstein's control over Safelon's operations generally, rather than his control over the finances of the corporation. We agree.

The district court acknowledged that Safelon "had a duty to cease operations in order to avoid generating additional tax liabilities," 713 F.Supp. at 123, and then concluded that Hochstein was not a person responsible for payment of Safelon's withholding taxes because "Hochstein *himself* had no power to cease Safelon's operations, no power to fire the remaining supervisor[y] employees, or any input into the decision to continue processing Safelon's supplies on hand," *id.* The power to continue corporate operations, however, is not required in order for section 6672 liability to attach.

Courts consider several factors in determining whether an individual is responsible for collecting and paying

withholding taxes, including the individual's duties as outlined in the corporate bylaws, his ability to sign checks, his status as an officer or director, and whether he could hire and fire employees. *Gephart* v. *United States*, 818 F.2d 469, 473 (6th Cir. 1987) (per curiam). The central question, however, is whether the individual has significant control over the enterprise's finances. *See, e.g., Ruth* v. *United States*, 823 F.2d 1091, 1094 (7th Cir. 1987); *Gephart*, 818 F.2d at 473; *Neckles* v. *United States*, 579 F.2d 938, 940 (5th Cir. 1978) (per curiam). While Hochstein was not an officer or director and had no authority to hire and fire employees, he did exercise significant control over Safelon's finances. He had the authority to sign checks in any amount; he signed and filed Safelon's payroll tax returns; he dealt with Rosenthal on a daily basis during Safelon's financial troubles; and he oversaw Safelon's bookkeeping.

Hochstein maintains that, to be held liable, he would have to have the ultimate authority to determine whether the government or other creditors should be paid, and asserts that he did not have such authority. This argument is without merit. While some courts have suggested that an individual is responsible under section 6672 only if he has the power to make the final decision on the order in which creditors will be paid, *see, e.g., Maggy*, 560 F.2d at 1374, we agree with the weight of authority that "[i]t is not necessary that an individual have the final word as to which creditors should be paid in order to be subject to liability under this section. Rather, it is sufficient that the person have significant control over the disbursement of funds." *Gephart*, 818 F.2d at 475; *see Neckles*, 579 F.2d at 940; *Brown* v. *United States*, 464 F.2d 590, 591 n.1 (5th Cir. 1972), *cert. denied*, 410 U.S. 908 (1973); *see also Schwinger* v.

United States, 652 F.Supp. 464, 467 (E.D.N.Y. 1987) (" 'final' in this context indicates significant rather than exclusive control").

The district court found that Hochstein "had nothing approaching the requisite power [to disburse funds]." 713 F.Supp. at 123. This finding is clearly erroneous. The record indicates that, in addition to Hochstein's check-signing authority, he made the initial determination of the order in which large bills were to be paid, subject to President Eckstein's approval, and that he had discretion to pay smaller bills. The fact that Hochstein was the person who requested funds on behalf of Safelon from Rosenthal also suggests that Hochstein was intimately involved in Safelon's financial affairs. Bearing in mind that Hochstein had the burden of proof on this issue, we conclude that he was a responsible person.[1] *See Howard* v. *United States*, 711 F.2d 729, 734 (5th Cir. 1983) (issuance of small checks without approval of superior demonstrated authority to pay taxes).

B. *Willfulness*

The district court went on to hold that, even if Hochstein was a responsible person, his failure to pay was not willful because he "did not give priority to other

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1 Hochstein was identified in a bank financial document as Safelon's secretary and treasurer, and in one piece of correspondence with Rosenthal as the corporation's treasurer. While we accept the district court's finding that Hochstein was never actually an officer or director of Safelon, we believe that his being held out as an officer of the corporation, for whatever reason, is relevant to his status as a responsible person. The fact that Eckstein allowed Hochstein to be identified as a corporate officer suggests that Hochstein occupied a fairly high position within the company, and his identification as treasurer implies that his role in Safelon's finances was more than clerical.

business obligations of Safelon, over the liability to the I.R.S." 713 F.Supp. at 124. While the question of willfulness in this context normally is a question of fact, *see Wright* v. *United States*, 809 F.2d 425, 428 (7th Cir. 1987); *Schwinger*, 652 F.Supp. at 469 n.3, we conclude that the district court erred as a matter of law in holding that Hochstein's failure to pay was not willful. *See Moore* v. *United States*, 465 F.2d 514, 515-16 (5th Cir. 1972) (sustaining charge to jury that conduct was willful as a matter of law), *cert. denied*, 409 U.S. 1108 (1973). Hochstein's payment of net wages to himself and other employees during the first two quarters of 1981 amounted to a willful failure to pay taxes.

A person willfully fails to pay withholding taxes within the meaning of section 6672 when he pays other creditors with knowledge that withholding taxes are due. *See, e.g., Wood* v. *United States*, 808 F.2d 411, 415 (5th Cir. 1987); *Kalb* v. *United States*, 505 F.2d 506, 511 (2d Cir. 1974), *cert. denied*, 421 U.S. 979 (1975). The individual's bad purpose or evil motive in failing to collect and pay the taxes "properly play no part in the civil definition of willfulness." *Monday* v. *United States*, 421 F.2d 1210, 1216 (7th Cir.), *cert. denied*, 400 U.S. 821 (1970). Hochstein admittedly knew that withholding taxes were not being paid. Indeed, he would be hard pressed to deny this because he was the one who normally paid the taxes. He argues, however, that his failure to collect and pay the taxes was not willful because Rosenthal provided him with funds to pay only net wages. There was no money, he asserts, with which to pay the withholding taxes. Hochstein's duty in this situation, however, was "to prorate such funds as [were] available between the Government and the employees." *Sorenson* v. *United States*, 521 F.2d 325, 328 (9th Cir.

1975); *see Collins* v. *United States*, 848 F.2d 740, 742 (6th Cir. 1988) (plaintiff's decision to pay wages and other suppliers when he knew of tax deficiency made his action willful); *Emshwiller* v. *United States*, 565 F.2d 1042, 1045 (8th Cir. 1977) (payment of net wages with knowledge that no funds existed to pay taxes was willful failure); *Schwinger*, 652 F.Supp. at 468 n.2. For purposes of determining willfulness, an employee to whom the corporate employer owes wages is simply another creditor.[2]

Hochstein also contends that his failure to collect and pay withholding taxes was not willful because, had he prorated the net wages between Safelon's employees and the government, he would have been subject to criminal prosecution under New York law for failure to pay wages. *See* N.Y. Labor L. § 198-a (McKinney 1986) (imposing criminal liability on officers and agents of employer for failure to pay wages). The issue whether failure to pay wages constitutes a criminal offense under state law arose during oral argument. Counsel for Hochstein subsequently directed our attention to section 198-a, and we then requested additional briefing on the applicability of this statute and its effect on the issue of Hochstein's willfulness. After carefully considering the submissions of the parties, we conclude that Hochstein's failure to collect and pay the taxes was willful.

Section 198-a does not render Hochstein's actions any less willful for two reasons. First, Hochstein's good

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2 The dissent suggests that had Hochstein used a portion of the net wages to pay withholding taxes he would have disobeyed Rosenthal's instructions. Because Rosenthal did not specify the purposes for which funds were to be used once they were given to Safelon, it is unclear how Hochstein's payment of taxes could have amounted to noncompliance with Rosenthal's instructions.

faith belief that New York law required him to prefer Safelon's employees over the federal government is not a defense to liability under section 6672. As noted above, an individual's good or bad motive in failing to collect and pay taxes is irrelevant to the willfulness determination. Second, it is not at all clear that Hochstein would have been subject to state criminal prosecution had he prorated the net wages. The withholding of federal taxes is expressly authorized by New York's Labor Law. *See* N.Y. Labor L. § 193(1)(a) (McKinney 1986) (authorizing deductions from wages "made in accordance with the provisions of any law"). In addition, were we to read section 198-a of New York's Labor Law to conflict with section 6672, then the federal statute necessarily preempts the state statute. *See Florida Lime & Avocado Growers, Inc.* v. *Paul*, 373 U.S. 132, 142-43 (1963) (preemption exists "where compliance with both federal and state regulations is a physical impossibility"); *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941) (proper inquiry is whether state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress"). New York simply could not criminalize the collection and payment of federal withholding taxes.

We appreciate the difficult situation in which Mr. Hochstein found himself during the early part of 1981. Had he prorated the funds he received from Rosenthal between the government and Safelon's employees, the employees might have refused to continue their employment, and as a result Hochstein may well have been fired. But these potential adverse consequences simply are no excuse for failing to collect and pay withholding taxes. As the Fifth Circuit stated in *Howard*, "[plaintiff] had a choice. He could have paid the taxes, accepted the

consequence[ ] [of being fired], and thus avoided the penalty. Neither his discomfort over not paying the taxes, nor his desire to see them paid, makes his failure to pay any the less willful." 711 F.2d at 735.

Hochstein also contends that the employees' wages would have received priority over federal taxes if Safelon had declared bankruptcy, and therefore he was free to pay net wages without collecting withholding taxes, given that he had limited funds. While wages do receive priority in bankruptcy to the extent of $2,000 per employee, *see* 11 U.S.C. § 507(a)(3), (7)(D), this is largely irrelevant because Safelon was not adjudicated a bankrupt. Further, an individual's liability under section 6672 is separate and distinct from the corporation's tax liability. *See Emshwiller*, 565 F.2d at 1047; *Moore*, 465 F.2d at 517. Thus, even if Safelon had sought protection under the bankruptcy laws, the IRS still could have assessed against Hochstein himself a penalty equivalent to any unpaid taxes. *See Spivak* v. *United States*, 370 F.2d 612, 616 (2d Cir.) (IRS' compromise of a claim against bankrupt corporation did not release individuals from their direct liability), *cert. denied*, 387 U.S. 908 (1967). Safelon's potential bankruptcy therefore does not insulate Hochstein from liability.

CONCLUSION

The district court's findings concerning Hochstein's control over Safelon's finances were clearly erroneous. Hochstein had significant control over Safelon's finances, and therefore was a person responsible for the collection and payment of Safelon's withholding taxes under 26 U.S.C. § 6672. The court erred as a matter of law in holding that, even if Hochstein was a responsible

person, his failure to pay the taxes was not willful. Accordingly, we vacate the district court's judgment and remand with instructions to dismiss the complaint and enter judgment in favor of the IRS on its counterclaim.

No costs.

JON O. NEWMAN, *Circuit Judge*, dissenting:

Arnold Hochstein was the controller of a company that went out of business. Two years before the end, a financing firm, Rosenthal & Rosenthal ("Rosenthal"), effectively took over financial control of the company, Safelon Corporation ("Safelon"), supplying operating funds in return for a security interest in the company's receivables and assets. Four months before the end, Rosenthal decided to liquidate the company and keep only enough employees to maximize revenues during the liquidation. All funds disbursed by Hochstein to pay bills came from Rosenthal. Hochstein requested sufficient funds to pay the net wages and the withholding taxes of the few remaining employees. Rosenthal refused, providing instead only funds to pay net wages. Hochstein continued with his duties during the final four months of the company's existence, often working in his overcoat because Rosenthal did not supply enough money for heat. For his trouble, Hochstein, whose annual salary was $35,000, is now held personally liable for some $30,000 in withholding tax penalties, an amount equal to the taxes due, but uncollected from, Safelon.

I do not believe the Government's need for taxes or the requirements of federal law justifies the Court's

imposition of "responsible person" liability upon Arnold Hochstein. *See* 26 U.S.C. § 6672 (1982). The District Court ruled in his favor. From the reversal of that ruling, I respectfully dissent.

As the majority recognizes, the central question in determining whether a person is "responsible" under section 6672 is whether the individual has significant control over the enterprise's finances. In the waning days of Safelon's existence, Hochstein had no such control. All of Safelon's revenue was turned over to Rosenthal. All funds for Safelon's operations had to be requested from Rosenthal. Rosenthal disbursed no money to Safelon unless the purposes for which the money was requested, almost entirely employees' net wages, was precisely set forth. Though, as the District Court noted, Rosenthal did not formally "earmark" specific purposes for the funds, 713 F. Supp. at 121, its provisions of precise dollar amounts sufficient in the aggregate to pay for only those items of the requested expenses that it chose to fund made it perfectly clear to Hochstein that Rosenthal, not Hochstein, was making the decision as to which bills should be paid. With respect to taxes, the matter could not have been clearer. Hochstein specifically requested enough money to pay to the few remaining employees their net wages *and* to pay to the I.R.S. the withholding taxes due with respect to those wages. As the District Court found, "In making requests for disbursements from Rosenthal, Hochstein stressed that payment of the employment taxes was of the 'highest priority.' " *Id.* at 122. In response to this emphatic request, Rosenthal refused to supply the money needed to pay taxes, choosing instead to furnish only enough money to pay net wages and one or two *de minimis* operating expense bills.

Once this limited amount of cash arrived, Hochstein realistically had no choice except to write checks for the items Rosenthal had decided to supply funds. If taxes were to be paid from those limited funds, a decision would have been required either to pay the employees less than their net wages, which would have resulted in their quitting and would likely have violated state law, or to reduce expenses by discharging some of the employees, thereby accelerating the rate of the company's shutdown. But those are business decisions that were in the hands of Rosenthal, the financier, and Ernest Eckstein, Safelon's president and majority shareholder. As the District Court explicitly found, "Hochstein was *not*, however, involved in any business decisions involving the operation or production aspects of the plant, including whether raw materials were to be purchased or processed, whether the plant would continue to operate in any capacity, or whether employees would be laid off." *Id.*

Hochstein can be deemed a "responsible person" only if that phrase covers any employee authorized to sign checks. The statute is not that broad. It imposes liability on persons who exercise some authority with respect to the decision whether or not to pay taxes. In the final four months of Safelon's operations, with its financier calling the shots and supplying all its funds, Hochstein's relationship to the checkbook was solely that of a scribe, not a decision-maker. The Government should collect its taxes from those who made the decision not to pay them.

Hochstein's lack of real decision-making authority may usefully be contrasted with that of the defendant in *Howard v. United States*, 711 F.2d 729 (5th Cir. 1983),

on which the majority relies. At the end of the period during which the defendant in *Howard* failed to pay withholding taxes, the company had "a substantial amount of money on deposit at its bank." *Id.* at 732. It is one thing to say that a defendant with check-signing authority for an on-going business with substantial cash in the bank is realistically making choices as to whether taxes should be paid and is "responsible" for not paying withholding taxes when he fails to write checks to the I.R.S. It is quite another to reach the same conclusion where a business is failing and its de facto receiver, while liquidating its assets, is supplying only the funds necessary to pay employees' net wages, despite the check-signer's request for sufficient money to pay taxes in full.

I also disagree with the Court's rejection of the significance of the New York statute that imposes criminal liability on agents of employers who fail to pay wages. *See* N.Y. Labor L. § 198-a (McKinney 1986). Noting that New York law authorizes withholding of federal taxes, the Court says it is not clear that Hochstein would have been subject to state prosecution had he "prorated the net wages." In allowing withholding, as it must in view of paramount federal law, New York would have permitted Hochstein to withhold a typical percentage, say 18 percent, from a *gross* wage payment. Had Rosenthal provided $100 for an employee's gross wages, Hochstein could have paid the employee $82 net wages and sent $18 to the I.R.S. But when Rosenthal provides Hochstein with only *net* wages for that employee, *i.e.*, $82, I seriously doubt that New York would consider lawful a payment to that employee of only $64. Yet that is the payment the Court holds that Hochstein should have made. Of course, New York can-

not criminalize withholding $18 and paying the employee his true net wages of $82. But New York has the clear right to insist that employees receive their full *net* wages, *i.e.*, net of just one bite of withholding taxes, not two.

After hearing all the evidence in this bench trial, Judge Leisure concluded that Hochstein was not a "responsible person." I do not understand in what respect he erred. Because I believe that his findings are fully supported, perhaps even compelled, by the evidence and that his ultimate conclusion is entirely consistent with applicable law, I dissent.

APPENDIX B — ORDER OF UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT ENTERED DECEMBER 19, 1991

NO. 91-6164

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 15th day of November, one thousand nine hundred and ninety-one.

PRESENT:
HONORABLE J. EDWARD LUMBARD,
HONORABLE JON O. NEWMAN,
HONORABLE RALPH K. WINTER,
Circuit Judges.

ARNOLD HOCHSTEIN,

Plaintiff-Appellant,

v.

UNITED STATES OF AMERICA,

Defendant-Appellee.

O R D E R

Appeal from the United States District Court for the Southern District of New York (Peter K. Leisure, Judge).

Appendix B

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York and was argued by counsel.

ON CONSIDERATION WHEREOF, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the judgment of the District Court be and it hereby is AFFIRMED.

Arnold Hochstein appeals from the June 19, 1990, judgment dismissing his complaint against the United States and entering judgment in favor of the Government on its counterclaim for the principal amount of $26,156.51, interest in the amount of $19,162.78 for the period up to June 15, 1990, and interest in accordance with law from the date of judgment. On appeal, Hochstein argues that the correct amount of interest owed as of June 15, 1990, was $5,421.00, plus the interest that accrued between May 3, 1989, and that date.

Hochstein's complaint challenged the Internal Revenue Service's (the "IRS") assessment against him for certain unpaid withholding taxes of Safelon Corporation. *See* 26 U.S.C. § 6672. Hochstein sought a declaration on non-liability and a refund of the amounts he had paid toward the assessment. The Government counterclaimed to collect the assessed amounts in full. The District Court entered judgment in favor of Hochstein following a bench trial. 713 F. Supp. 119 (S.D.N.Y. 1989). On appeal, this Court vacated and remanded with directions to the District Court to enter judgment in favor of the Government on its counterclaim. 900 F.2d 543 (2d Cir. 1990).

On remand, the District Court signed the Government's proposed judgment for $45,319.29. Hochstein thereafter sought to set aside the District Court's judgment, arguing that the trial

evidence supported a judgment of only $31,577.51. Magistrate Judge James C. Francis IV held a hearing on the issue and issued a report and recommendation supporting the District Court's original judgment. The District Court adopted the Report in a memorandum order dated April 23, 1991. This appeal followed.

At the original trial, the Government introduced a certified record of Hochstein's civil penalty assessment. The document was dated May 3, 1989. When asked what the document showed about the status of Hochstein's assessment, Karen Ellen Andersson, an IRS Tax Examining Assistant, testified that the document showed that "[i]ts *current* status is a liability of $31,577.51." (emphasis added). The parties agree that the amount of principal owed by Hochstein is $26,171.51. Therefore, $5,421.00 of Hochstein's total assessed liability of $31,577.51, as reflected in the document, consisted of interest.

While the parties agree that interest began accruing on March 26, 1985, they disagree on whether the $5,421.00 represents interest accrued from that date until January 5, 1987, or until May 3, 1989. Hochstein argues that because the document was dated May 3, 1989, the document should be deemed as a matter of law to cover the time period up to the date of the document. Thus, Hochstein argues that he now owes $31,577.51, plus the interest that accrued *after* May 3, 1989. The Government argues that although the document was dated May 3, 1989, the document clearly indicates that the $5,421.00 figure represents the interest *assessed* as of January 5, 1987, not the interest *accrued* as of May 3, 1989.[1]

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1. Interest accrues from the date that a tax becomes due until the date of payment. Assessed interest is the interest that is recorded as part of the assessment made on a particular day, although interest continues to accrue until payment is made.

We agree. At the hearing before the Magistrate Judge, Anderson clarified any ambiguity in her trial testimony by explaining that the May 3 document reflected only the interest that had accrued as of January 5, 1987. Similarly, Irwin Marvald, an Advisor in the Special Procedures Function of the IRS, testified at the hearing that the document was certified on May 3 but the interest accrued through that date had not yet been assessed. The supporting documentation and calculations clearly indicate that $5,421.00 of interest accrued between March 26, 1985, and January 5, 1987, another $13,741.78 accrued between January 5, 1987, and June 15, 1990, thereby producing the total interest which the District Court awarded — $19,162.78.

Hochstein's reliance on *Brafman v. United States*, 384 F.2d 863 (5th Cir. 1967), and Treasury Regulation § 301.6203-1 is misconceived. *Brafman* held that the Government failed to make a valid assessment because the appropriate IRS official did not sign the certificate of assessment as required by Treasury regulations. The Court noted that the Government may postpone the signing of a prepared certificate because of the limitations on collection and lien perfection that begin to run at the time of the assessment. 384 F.2d at 867. While such policy reasons may support a strict application of the Treasury regulation's signature requirement, no policy supports Hochstein's contention that the period in which interest accrues should be determined solely on the basis of the date on which the certificate of assessment is signed.

Hochstein also argues that the Government should not have received an opportunity to introduce evidence not introduced at trial. This argument is unavailing because the May 3 document, which was introduced at trial, indicated that the $5,421.00 figure represented interest accrued up to January 5, 1987. Furthermore,

interest on a section 6672 penalty accrues by statute, and therefore the interst owed is a matter of law and does not have to be proved at trial. *See United States v. Schroeder*, 900 F.2d 1144, 1150 n.5 (7th Cir. 1990).

s/ J. Edward Lumbard

s/ Jon O. Newman

s/ Ralph K. Winter

Circuit Judges

N.B. THIS SUMMARY ORDER WILL NOT BE PUBLISHED IN THE FEDERAL REPORTER AND SHOULD NOT BE CITED OR OTHERWISE RELIED UPON IN UNRELATED CASES BEFORE THIS OR ANY OTHER COURT.

A TRUE COPY
ELAINE B. GOLDSMITH
Elaine B. Goldsmith
Clerk

THIS DOCUMENT WAS ENTERED ON THE DOCKET ON 12-19-91

APPENDIX C — MEMORANDUM ORDER OF THE UNITED STATES DISTRICT COURT DATED APRIL 23, 1991

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

87 Civ. 2094 (PKL)

ARNOLD HOCHSTEIN,

Plaintiff and Counterclaim Defendant,

-against-

UNITED STATES OF AMERICA,

Defendant and Counterclaim Plaintiff.

MEMORANDUM ORDER

LEISURE, *District Judge,*

After the entry of judgment in this tax refund action, plaintiff Arnold Hochstein (hereinafter "Hochstein") challenged the amount of the judgment. His objections were construed by the Court as a motion for relief from the judgment pursuant to Federal Rule of Civil Procedure 60(b), and the matter was referred to Magistrate Judge James C. Francis IV for an evidentiary hearing to determine the proper amount of the judgment. On February 19, 1991, Judge Frances filed a Report and Recommendation ("Report"), in which he recommended that the Court deny Hochstein's motion to modify the judgment. Plaintiff has filed a timely objection to that Report.

Appendix C

BACKGROUND

While the facts in this case are more fully set out in Judge Francis' Report, the procedural history of the case is as follows. Hochstein, the controller of Safelon Corporation, sought a ruling from this Court that he was not a "responsible person" for the purposes of collecting and paying Safelon's taxes within the meaning of 26 U.S.C. § 6672. The decision of this Court in favor of Hochstein was vacated on appeal, and the case was remanded with instructions to dismiss Hochstein's complaint and to enter judgment in favor of the government on its counterclaim. *Hochstein v. United States*, 713 F. Supp. 119, 123 (S.D.N.Y. 1989), *vacated*, 900 F.2d 543 (2d Cir. 1990).

The Court adopted a proposed judgment submitted by the government, holding Hochstein liable for a principal amount of $26,156.51, plus $19,162.78 in interest, for a total of $45,319.29. After the entry of judgment by the Court, plaintiff objected, maintaining that proof at trial warranted a judgment of only $31,577.51. The matter was referred to Judge Frances, with instructions to treat plaintiff's objections as a motion for relief from the judgment pursuant to Fed. R. Civ. P.60(b), and to hold an evidentiary hearing to determine the proper amount of the judgment.

After a hearing and the submission of post-hearing briefs, Judge Francis recommended that this Court deny plaintiff's motion for relief from the judgment.

DISCUSSION

Plaintiff's objections to the Report and Recommendation focus on two issues: (1) that the government did not, either at

the trial or the post-trial hearing, satisfy its burden of proof that as to the existence of an assessment consistent with government regulations; and (2) that plaintiff never waived his right to challenge the amount calculated by the government. This Court has conducted a *de novo* review of the record with regard to these objections, as required under Federal Rule of Civil Procedure 72(b).

I. Proof of Assessment

As Judge Francis pointed out, plaintiff did not contest the government's proof of the assessment until after the post-trial hearing, in his post-hearing memorandum, and affirmatively argued the fact of an assessment in his complaint. Such a belated assertion of an argument operates as a waiver. *See Bank of Am. Nat'l Trust & Sav. Ass'n v. Mamakos*, 509 F.2d 1217, 1219 (9th Cir. 1975). Judge Francis also concluded that the proof of the assessment presented by the government at the trial and the post-trial hearing was sufficient.

Moreover, under the circumstances of this case, this Court may not now reconsider whether the government has failed to prove the existence of an assessment, an essential element of its counterclaim. The Second Circuit remanded the case to this Court "with instructions to dismiss the complaint and *enter judgment in favor of the IRS on its counterclaim*." *Hochstein, supra*, 900 F.2d at 550 (emphasis added).

Under the doctrine of the law of the case, when "a case has been decided by an appellate court and remanded, the court to which it is remanded must proceed in accordance with the mandate and such law of the case as was established by the appellate court." *Soto-Lopez v. New York City Civil Servs. Comm'n*, 840 F.2d

162, 167 (2d Cir. 1988) (quoting *United States v. Fernandez*, 506 F.2d 1200, 1202 (2d Cir. 1974) (quoting IB J. Moore, Federal Practice ¶ 0.404[10], at 571 (2d ed. 1974)). The Second Circuit has emphasized that "this doctrine imposes a duty on a lower court to follow a ruling made by the reviewing court at an earlier stage of the case, and . . . the lower court has no discretion to disregard that duty." *Id.* Thus, this Court has no discretion to consider whether the government should prevail on its counterclaim, and will address only the issue of the amount of the judgment.

II. Amount of Judgment

The evidence at trial, together with that presented at the post-trial hearing, supports the determination that the amount owed by Hochstein as of June 15, 1990, was $45,319.29. Hochstein has never contested the correctness of the government's actual calculations. Rather, he objects to the fact that the government's witness at trial testified only to a sum representing Hochstein's liability for principal and interest assessed as of an earlier date, rather than the total figure for principal and interest accrued as of the date of judgment. However, as Judge Francis points out, the record may be reopened for the submission of additional evidence at the Court's discretion, *see Zenith Radio Corp. v. Hazeltine Research, Inc.*, 401 U.S. 321, 331 (1971); *B.V. Bureau Wijsmuller v. United States*, 702 F.2d 333, 342 (2d Cir. 1983), and the supplementation of the record causes no prejudice to plaintiff in this case, since he has never attempted to rebut the government's calculations.

Furthermore, once evidence of the amount of principal owed is established, a figure not contested by plaintiff, the calculation of interest is governed by statute and regulation, and is therefore

a matter of law. *See United States v. Faulkner*, 119 F.R.D. 390, 390-91 (N.D. Ill. 1988); *cf. United States v. Warner*, 855 F.2d 372, 373 (7th Cir. 1988). Judge Francis concluded, and this Court agrees, that despite some ambiguities in the testimony of the government's witness at trial, the testimony presented at the post-trial hearing clarified the issue and established the correctness of the government's calculations as to the accrued interest owed by plaintiff.

The movant bears the burden of proof in a Rule 60(b) motion. *See, e.g., Kotlicky v. United States Fidelity & Guaranty Co.*, 817 F.2d 6, 9 (2d Cir. 1987); 11 C. Wright & A. Miller, Federal Practice and Procedure § 2857 (1973). Plaintiff has offered no persuasive reasons to vacate or modify the judgment previously entered in this case, and therefore his motion is denied.

CONCLUSION

For the reasons stated above, the Court adopts the Report of Judge Francis, dated February 19, 1991. Plaintiff's motion for relief from the judgment is denied.

SO ORDERED

April 23, 1991
New York, New York

s/ Peter K. Leisure
U.S.D.J.

Appendix C

Copies of this memorandum order have been sent to:

Stephen R. Sugrue, Esq.
Lowenthal, Landau, Fischer & Ziegler, P.C.
250 Park Avenue
New York, New York 10177

Craig A. Stewart, Esq.
Assistant United States Attorney
One St. Andrew's Plaza
New York, New York 10007

Magistrate Judge Francis

APPENDIX D — REPORT AND RECOMMENDATION OF MAGISTRATE JUDGE JAMES C. FRANCIS IV DATED FEBRUARY 19, 1991

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

87 Civ. 2094 (PKL)

ARNOLD HOCHSTEIN,

Plaintiff and Counterclaim Defendant,

-against-

UNITED STATES OF AMERICA,

Defendant and Counterclaim Plaintiff.

TO THE HONORABLE PETER K. LEISURE, U.S.D.J.:

This is a tax refund action in which judgment was entered in favor of the government on its counterclaim in the amount of $45,319.29. Plaintiff Arnold Hochstein then challenged the amount of the judgment. The Court construed these objections as a motion for relief from the judgment pursuant to Rule 60(b) of the Federal Rules of Civil Procedure and referred the case to me for an evidentiary hearing to determine the proper amount of the judgment.

Background

Arnold Hochstein was the controller of Safelon Corporation, a manufacturing business. When Safelon encountered financial difficulties, it ceased making withholding and Federal Insurance

Contributions Act ("FICA") payments to the Internal Revenue Service ("IRS"). The IRS then assessed a penalty against Mr. Hochstein equal to the unpaid withholding and FICA taxes. Mr. Hochstein made partial payment but then initiated this action, seeking a refund of the amount paid and abatement of the balance of the assessment. The government counterclaimed for the portion of the taxes still unpaid, plus interest.

Following trial, the Court ruled in Mr. Hochstein's favor. It held that he was not "responsible" for collecting and paying Safelon's taxes within the meaning of 26 U.S.C. § 6672. *Hochstein v. United States*, 713 F. Supp. 119, 123 (S.D.N.Y. 1989), *vacated and remanded*, 900 F.2d 543 (2d Cir. 1990). Further, the Court found that even if he were in fact a responsible person under § 6672, his failure to make the required payments was not sufficiently willful to create liability. *Id.* at 123-24.

A divided panel of the Second Circuit disagreed with these determinations. *Hochstein v. United States*, 900 F.2d 543 (2d Cir. 1990). Accordingly, it vacated the judgment and remanded with instructions that judgment be entered for the government on the counterclaim.

The government then submitted a proposed judgment, which the Court adopted, holding the plaintiff liable for a principal amount of $26,156.51 together with $19,162.78 in interest, for a total of $45,319.29. Mr. Hochstein objected, arguing that the proof at trial warranted a judgment of only $31,577.51. The Court then referred the controversy to me with directions to treat the plaintiff's objections as a motion for relief from the judgment under Rule 60(b) of the Federal Rules of Civil Procedure and to hold an evidentiary hearing to ascertain the proper amount of the judgment.

Appendix D

The Hearing

The testimony presented at the original trial regarding the magnitude of Mr. Hochstein's liability was ambiguous at best. There, the IRS witness, Karen Ellen Andersson, first testified about Mr. Hochstein's tax liability as follows:

> Q. Ms. Andersson, I direct your attention now to Government Exhibit A-2. Would you tell us what Government Exhibit A-2 is? A. This is a certified record of Arnold Hochstein's 1005 civil penalty assessment.
>
> Q. What does Government Exhibit A-2 say about the status of the assessment? A. Its current status is a liability for $31,577.5131 [sic].

(T.Tr. 93-94; H.Tr. 15-16).[1] This testimony was taken on May 8, 1989, and the document referred to, dated May 3, 1989, reflected a total assessment of $31,577.51. Gov't exh. 1. However, Ms. Andersson subsequently testified on cross-examination that the document only showed Mr. Hochstein's total indebtedness as of January 5, 1987 (T.Tr. 96).

At the evidentiary hearing following entry of judgment, Ms. Andersson clarified her trial testimony. She stated that the figure of $31,577.51 included interest assessed only through January 5, 1987 together with certain credits and debits calculated up to April 15, 1987 (H.Tr. 12-14, 16). She further acknowledged that the

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1. "T.Tr." refers to the transcript of the trial, and "H.Tr." refers to the transcript of the subsequent evidentiary hearing.

certified record of Mr. Hochstein's liability admitted at trial did not reflect the then "current" status of his account. (H.Tr. 16-17).

Finally, it was established at the hearing that Mr. Hochstein's liability at the time of entry of judgment on June 15, 1990 was in fact the amount sought by the government. (H.Tr. 38). The principal amount was $26,171.51 as of January 5, 1987, as reflected in the computer printout admitted at trial. (H.Tr. 29-31; Gov't exh. 1). Subsequently, the IRS adjusted this figure downward to $26,156.51 as the result of a small credit to Mr. Hochstein and a charge for a lien filing. (H.Tr. 34-35; Gov't exh. 7). Further, by the time of the hearing before me, the government witness had added the interest assessed from January 5, 1987 to June 15, 1990, bringing the total to $45,319.29. (H.Tr. 32-39; Gov't exh. 7).

Discussion

The plaintiff presents two alternative arguments in support of its motion to modify the judgment. First, he argues that the Court erred in granting judgment in an amount unsupported by the trial evidence and contends that that error should now be corrected. Second, Mr. Hochstein asserts that at both the trial and the post-trial hearing, the government failed to prove that any valid assessment was made because it did not introduce the summary record signed by an assessment officer.

A. Relief from the Judgment

The plaintiff's initial contention, then, is that the Court mistakenly relied on information outside the trial record. As a threshold matter, there is substantial disagreement among the courts over whether judicial error is a proper basis for granting

a Rule 60(b) motion. *See Center for Nuclear Responsibility, Inc. v. United States Nuclear Regulatory Comm'n*, 781 F.2d 935, 939-40 (D.C. Cir. 1986) (citing cases). The Second Circuit has indicated that such relief is rarely available, the usual recourse being to file an appeal. *See In re Texlon Corp.*, 596 F.2d 1092, 1100 (2d Cir. 1979).

But in this case any "mistake" by the Court was rectified if the record was properly reopened for the government's submission of additional evidence. A determination whether to reopen a record is committed to the Court's discretion. *See Zenith Radio Corp. v. Hazeltine Research, Inc.*, 401 U.S. 321, 331 (1971); *B.V. Bureau Wijsmuller v. United States*, 702 F.2d 333, 342 (2d Cir. 1983). Here, that discretion was properly exercised, and the additional evidence presented at the post-trial hearing may therefore be considered. The calculation of interest on unpaid taxes is a purely objective determination, and limiting the government to its trial evidence would place the Court's imprimatur on demonstrably erroneous findings. Furthermore, permitting the record to be supplemented causes no prejudice to the plaintiff, since he has never offered proof to rebut the government's calculation of interst. Thus, it would be manifestly unjust to deny the government relief and to provide a windfall to the plaintiff because of the ambiguity of the trial testimony. As indicated above, the evidence at trial, as supplemented by that presented at the post-trial hearing, shows that the current judgment accurately reflects the amount owed by Mr. Hochstein as of June 15, 1990. The plaintiff has never controverted this.

B. Proof of Assessment

Section 6203 of the Internal Revenue Code, 26 U.S.C. § 6203, provides that an assessment

> shall be made by recording the liability of the taxpayer in the office of the Secretary in accordance with rules or regulations prescribed by the Secretary. Upon request of the taxpayer, the Secretary shall furnish the taxpayer a copy of the record of the assessment.

The Secretary of the Treasury has implemented the statute by promulgating 26 C.F.R. § 301.6203-1, which reads as follows:

> The district director and the director of the regional service center shall appoint one or more assessment officers. The district director shall also appoint assessment officers in a Service Center servicing his district. The assessment shall be made by an assessment officer signing the summary record of assessment. The summary record, through supporting records, shall provide identification of the taxpayer, the character of the liability assessed, the taxable period, if applicable, and the amount of the assessment. The amount of the assessment shall, in the case of tax shown on a return by the taxpayer, be the amount so shown, and in all other cases the amount of the assessment shall be the amount shown on the supporting list or record. The date of the assessment is the date the summary record is signed by an assessment officer. If the taxpayer requests a copy of the record of assessment, he shall be furnished a copy of the pertinent parts of the assessment which set forth the name of the taxpayer, the date of assessment, the character of the liability assessed, the taxable period, if

applicable, and the amounts assessed.

The plaintiff argues that the government failed to submit proof of assessment consistent with this regulation either at trial or at the post-trial hearing.

The initial difficulty with this argument is that Mr. Hochstein never raised it until after the hearing on the accuracy of the judgment. Although the plaintiff vigorously contested liability in his post-trial brief, he never suggested that the government had not adequately proven the assessment. *See* Plaintiff's Post-Trial Memorandum. Even when he first challenged the judgment, Mr. Hochstein did so only on the basis that the government had proven a lesser amount at trial, not that its proof was legally inadequate. *See* Letter of Stepehn R. Sugrue dated June 18, 1990. Finally, at the post-trial hearing, Mr. Hochstein's attorney stated that "we will concede the accuracy of [the government witness'] testimony the first time we heard it [at trial]. (T.Tr. 5). It was not until his post-hearing memorandum that the plaintiff first contended that *no* valid proof of assessment had been offered. Mr. Hochstein has thus waived the opportunity to assert this argument. *See Bank of America National Trust & Savings Ass'n v. Mamakos*, 509 F.2d 1217, 1219 (9th Cir. 1975) (failure to raise argument until after summary judgment granted constitutes waiver).

Even if Mr. Hochstein is permitted to advance this argument now, he does not prevail. Once a civil action has been initiated, the government must provide proof of the pertinent aspects of assessment, including "identification of the taxpayer, the character of the liability assessed, the taxable period, and the date and amount of the assessment." *United States v. Chila*, 871 F.2d 1015, 1017 (11th Cir.), *cert. denied*, ____U.S.____, 110 S. Ct. 498 (1989).

However, this requirement may be met by introducing documents such as a certified copy of the computer transcript of the taxpayer's account, as was done here. *Id.* at 1017-18; *cf. United States v. Berman*, 825 F.2d 1053, 1055-57 & n.3 (6th Cir. 1987) (such proof met statutory requirement; issue of whether it complies with regulation not reached).

The summary record signed by the assessment officer may be necessary where it provides the only proof of a necessary element. For example, if the date of assessment is relevant to a statute of limitations defense, the date on which the IRS officer formally made the assessment may be critical. *See Brafman v. United States*, 384 F.2d 863, 865-66 (5th Cir. 1967). But that is not the case here. Since the form of proof presented by the government at both the trial and the post-trial hearing provided sufficient information on all contested issues, it was an adequate foundation for the entry of judgment.

Finally, the government was under no obligation, either at trial or in the post-trial hearing, to prove any assessment other than the assessment for the principal amount. Once satisfactory evidence has been presented of the date and amount of the principal assessment, the government is entitled as a matter of law to prejudgment interest. *See United States v. Faulkner*, 119 F.R.D. 390, 390-91 (N.D. Ill. 1988); *cf. United States v. Warner*, 855 F.2d 372, 373 (7th Cir. 1988). Thus, the assessment proven at the post-trial hearing was merely the equivalent of a judgment for the principal amount plus required prejudgment interest. As such, it was correct.

Conclusion

For the reasons set forth above, I recommend that the

plaintiff's motion to modify the judgment be denied. Pursuant to Rule 72 of the Federal Rules of Civil Procedure, the parties shall have ten (10) days to file written objections to this Report and Recommendation. Such objections shall be filed with the Clerk of the Court, with extra copies delivered to the chambers of the Honorable Peter K. Leisure, Room 608, and to the chambers of the undersigned, Room 633.

Respectfully submitted,

James C. Francis IV
JAMES C. FRANCIS IV
UNITED STATES MAGISTRATE
JUDGE

Dated: New York, New York
February 19, 1991

APPENDIX E — JUDGMENT OF UNITED STATES COURT OF APPEALS AFTER APPEAL DATED JUNE 14, 1990

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

87 Civ. 2094 (PKL)

ARNOLD HOCHSTEIN,

Plaintiff and Counterclaim Defendant,

-against-

UNITED STATES OF AMERICA,

Defendant and Counterclaim Plaintiff.

WHEREAS, by decision dated April 3, 1990, the United States Court of Appeals for the Second Circuit remanded the above-captioned case to the district court with instructions to dismiss the complaint of the plaintiff Arnold Hochstein and to enter judgment for the United States of America on its counterclaim, pursuant to 26 U.S.C. § 6672, against Arnold Hochstein; and,

WHEREAS, the Court of Appeals has now issued a mandate returning this case to this district court for disposition in accordance with those instructions; and,

WHEREAS, as of June 15, 1990, pursuant to claims alleged in the counterclaim in this case, Arnold Hochstein owes principal in the amount of $26,156.51 and interest in the amount of $19,162.78;

Appendix E

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the complaint of Arnold Hochstein against the United States of America is dismissed; and,

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the United States of America shall have judgment on its counterclaim against Arnold Hochstein in the amount of $45,319.29, plus interest in accordance with law from the date of judgment.

Dated: New York, New York
June 14, 1990

Peter H. Leisure
United States District Judge

Entered on the docket 6-19-20

APPENDIX F — DISTRICT COURT DECISION AFTER TRIAL REPORTED AT 713 F. SUPP. 119 (S.D.N.Y. 1989)

Arnold HOCHSTEIN,

Plaintiff,

v.

UNITED STATES of America,

Defendant.

No. 87 Civ. 2094 (PKL)

UNITES STATES DISTRICT COURT
S.D. New York

May 26, 1989

Lowenthal, Landau, Fischer & Ziegler, P.C., New York City (Stephen R. Sugrue, of counsel), for plaintiff.

Benito Romano, U.S. Atty. S.D.N.Y., New York City (Craig A. Stewart, James L. Garrity, of counsel), for defendant.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

LEISURE, District Judge.

This case was tried without a jury in mid May, 1989. The parties made pre-trial submissions, and, after the conclusion of evidence, were given the opportunity to make brief post-trial submissions by May 19, 1989. The following constitutes this Court's findings and conclusion under Fed.R.Civ.P. 52(a).

Appendix F

The dispute involves federal withholding and Federal Insurance Contributions Act ("FICA") taxes alleged to be owed to the United States ("defendant" or the "government") by the plaintiff Arnold Hochstein ("plaintiff" or "Hochstein"). This liability is said to arise by virtue of the failure of plaintiff's former employer Safelon Corporation ("Safelon") to make FICA and withholding tax payments for the first and second quarters of 1981.

The taxes were assessed against plaintiff individually, pursuant to 26 U.S.C. § 6672.[1] Partial payments were extracted from plaintiff. *See* GX A-2; Tr. 94-95; Complaint ¶ 15.[2] He now sues: 1) to recover the partial payments; 2) for an abatement of the balance of the assessment, to the extent that it has not been paid by plaintiff, and 3) for an injunction prohibiting defendant from taking steps against plaintiff in the future to recover taxes or penalties arising from the employment or withholding taxes of Safelon. Defendant has counterclaimed for the balance allegedly due under § 6672(a), or $31,577.51, plus statutory interest to the day of judgment.

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1. Section 6672(a) of the I.R.C. reads as follows:

> Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade any such tax or the payment thereof shall, in addition to the other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded or not collected, or not accounted for and paid over . . . .

2. References in the form "PX____" are to numbered plaintiff's exhibits, "GX____" to lettered government exhibits, and "Tr.____" to specific pages of the trial transcript.

Appendix F

Background

Safelon was in the business of manufacturing polyethylene bags, until it ceased operations in 1981. While it was an active corporation, Safelon was affiliated with another concern called Multifilm Corporation.

Hochstein commended his employment with Safelon in January, 1963. Throughout his employment with Safelon, he served as its Controller. By the time he left the company upon its dissolution in 1981, his annual salary was close to $35,000. Throughout the relevant period, an individual named Ernest Eckstein ("Eckstein") was Safelon's President and its majority stockholder.

Safelon first began experiencing financial difficulties in the early 1970's. Prior to that time, all of Safelon's obligations, including payroll tax obligations, were paid in a timely fashion. *See*, Tr. 13-14. Because of these financial difficulties, however, in 1973 Safelon was for the first time unable to make required payments, including withholding and FICA taxes. At that point, partly because of its inability to meet federal employment tax obligations, Safelon entered into voluntary bankruptcy under Chapter 11 of the Bankruptcy Code. Tr. 15. Safelon emerged from bankruptcy with the aid of a factoring company, Lazard Financial Company, ("Lazard"), and through that factoring arrangement, paid the full amount of back taxes due.

Through 1979, Safelon continued to experience worsening financial difficulties, and, upon the withdrawal of Lazard, found itself in need of new sources of financing. Eckstein entered into negotiations with a New York commercial finance company, Rosenthal & Rosenthal ("Rosenthal"). In April of 1979, Safelon

and Rosenthal entered into a financing agreement (the "Agreement"), whereby Rosenthal supplied operating funds to Safelon, pursuant to a formula based on Rosenthal's interest in Safelon receivables and assets. *See*, PX 1. In return for these advancements, Safelon assigned, as collateral security, accounts receivable, inventory, machinery and equipment, furniture, fixtures and vehicles. Hochstein had nothing to do with the negotiation or execution of the Agreement, and was not called upon to consult with Eckstein or anyone else regarding the accomplishment of this arrangement. *See* TR. 21.

Subsequent to the execution of the Agreement, checks received by Safelon from customers were immediately endorsed over to Rosenthal. Other checks were actually sent directly to Rosenthal by customers. *See e.g.*, Tr. 24-25. Under the Agreement Rosenthal had the power to directly endorse, for itself, checks that were made out to Safelon; Rosenthal so endorsed such checks whenever it received them. Tr. 28. A Safelon endorsement was not needed for transmittal of checks from Safelon customers to Rosenthal accounts, and Rosenthal received such checks regularly. Safelon was not permitted to maintain its own discretionary accounts, or to collect its own accounts receivable. Tr. 26-27, 116.

Hochstein's activities for Safelon during the period that the Agreement was in force were substantially governed by its terms.[3] Tr. 24-25. Hochstein was Safelon's general contact with Rosenthal, and would make specific requests to Rosenthal for funds, indicating the reason for such requested disbursements. Rosenthal

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3. A Safelon employee named Fred Reitbower initially had responsibilities under the Agreement similar to those that Hochstein later performed. Reitbower left Safelon in 1980. *See* Tr. 32-34, 61.

would respond to those requests, in accordance with Safelon's perceived needs, under the Agreement. *See,* Tr. 100-03. Rosenthal would not, however, earmark any specific purposes for the funds, and maintains that it had no control of expenditures once the monies went to Safelon. The Rosenthal disbursements, however, were Safelon's *only* source of operating funds, Tr. 30, 117. Although the Agreement stated that it was Safelon's obligation to make all tax payments, those taxes could only be paid from the specific funds advanced by Rosenthal. Tr. 75, 115. Safelon never held back funds or receivables from Rosenthal to make these, or any other, payments.

By 1981, sales continued to decline and the financial position of Safelon worsened. Rosenthal refused to make additional funds available, Tr. 34, and a decision was made to liquidate the Safelon debt to Rosenthal. *See,* Tr. 114. During the fourth week of January, 1981, Safelon ceased to make federal withholding and FICA tax payments on behalf of its employees. Safelon continued to operate and pay employees, albeit on a significantly reduced scale, through the second week of May, 1981. The funds secured from Rosenthal were insufficient to meet the entire payroll, to pay the payroll taxes, and even to heat the building. *See* Tr. 36. Consequently, the heat to the plant was cut off, the plant was operated on a reduced ⅓ day shift, and most non-supervisory employees were laid off. *See* Tr. 36, 38. These developments occurred in the winter months. The temperatures in the plant were as cold, and often even colder than, the temperature outside.

The reduced workforce continued to process the supplies and inventory which Safelon had already purchased, through the first and second quarters of 1981. The paychecks that the remaining employees continued to receive were for services *already* performed; wages were therefore owed and due to employees by

the time Rosenthal made disbursements for those periods.

At trial, the government made much of the fact that payments for a generator, which was acquired and operated after the heat was cut off, were not provided for by specific Rosenthal disbursements. *See, e.g.*, Tr. 65. To the extent that these payments occurred, they were clearly *de minimus*, and did not represent any significant prioritizing of payments over the liabilities to the IRS. The government additionally introduced a single Safelon "authorization" for a $10,000 payment by Rosenthal to a third party. *See* GX F; Tr. 59. That "authorization," however, was issued *at the request of Rosenthal. See*, Tr.122. That payment merely added to the more than $800,000 debt already owed by Safelon to Rosenthal. It did *not* represent a positive cash balance in any account of Safelon, or an ability of Hochstein to make independent disbursements of funds. Tr. 69, 123.

Substantially all of the demands for payment by Safelon's creditors went unsatisfied after the fourth week of the first quarter of 1981. *See, e.g.*, Tr. 36, 45-47; PX 4. As noted above, the only significant payments made after that date were to the remaining employees, for services which they had already rendered. Hochstein understood that the obligation to pay already earned wages to workers was an inflexible legal requirement. *See*, Tr. 70.

In 1981, plaintiff and Eckstein were the only two individuals authorized to sign checks on Safelon's account. Tr. 58. Plaintiff signed Safelon's withholding tax returns and disbursements to creditors. Hochstein was *not*, however, involved in any business decisions involving the operation or production aspects of the plant, including whether raw materials were to be purchased or processed, whether the plant would continue to operate in any capacity, or whether employees would be laid off. *See e.g.*, Tr. 11-12.

Appendix F

Hochstein was never a shareholder, director or officer of Safelon. *See, e.g.*, Tr. 9, 17.[4] He was, however, identified as Safelon's "treasurer" in a bank financial document with Hudson Valley National Bank in 1978, *See* GX P; Tr. 15, 57, and on one piece of correspondence to Rosenthal. GX F. The financial transaction with Hudson Valley National Bank required that Hochstein be listed as a corporate officer. Tr. 17. Hochstein was never aware of any corporate resolution nominating or designating him as treasurer, and he never received any additional benefits or remuneration for such a position. Tr. 18. The statement of Safelon's corporate officers which was executed in conjunction with the Rosenthal Agreement did not list Hochstein as an officer. *See* PX 2, Tr. 31.

Hochstein was generally responsible for preparation of Safelon's tax returns, Tr. 64, and he prepared a tax return for the first quarter of 1981. *See* PX 5. That return indicated payment of the obligations for the first three weeks of the quarter, and a failure to make subsequent payments. Safelon could not make those payments because Rosenthal did not make sufficient funds available. *See* Tr. 51, 117.

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4. The government actively attempted to establish that Hochstein was an officer of Safelon, but nevertheless vigorously argued that liability is not dependent upon formal corporate titles.

As indicated below, the legal position of the government is essentially correct; the status, duty and authority of the person, regardless of their formal title, is determinative. *See, e.g., Gephart v. United States*, 818 F.2d 469, 474 (6th Cir. 1987). Nevertheless, it is clear that Hochstein was not an officer or shareholder of Safelon, and that may be relevant to, although not dispositive of, the "responsible person" inquiry.

Appendix F

Hochstein's role in the continuing operations of Safelon after the third week of the first quarter of 1981 diminished. He would typically process receivables for Rosenthal in the morning, and continue his active search for new employment during the rest of the day. Tr. 39. In making requests for disbursements from Rosenthal, Hochstein stressed that payment of the employment taxes was of the "highest priority," Tr. 56, and he understood that failure to pay those taxes could result in penalties. Tr. 67-68. Throughout this dispute with the IRS, Hochstein has cooperated fully with audits and investigations by the IRS. *See, e.g.*, Tr. 52-55, PX 6.

In March of 1981, Eckstein conducted a sale of the remaining physical assets of Rosenthal, which satisfied the balance of the amounts due Rosenthal. Rosenthal actually purchased the assets of Safelon, Tr. 41, and then sold them at auction to recover its interests. *See* Tr. 44; PX 8.

Discussion

As noted, the relevant statute here is 26 U.S.C. § 6672.[5] The

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5. At trial, plaintiff's counsel argued that I.R.C. § 3505(b) might also be relevant. That provision provides, *inter alia*, for tax liability for third party lenders, where the lender is aware that the employer is using the funds specifically for the payment of wages, and where the advanced funds are insufficient to cover employment taxes.

Although an action against Rosenthal might have been pursued under that provision, that is clearly irrelevant to the issues in this case. It is well established, and conceded, that the IRS could pursue any of a number of responsible persons who might be liable. Possible liability of other parties, even if it appears they might be "more" liable than plaintiff here, is *not* to be considered for the present determinations. *See, e.g., Howard v. United States*, 711 F.2d 729, 737 (5th Cir. 1983).

burden of proof in recovery cases under that provision is on the taxpayer/plaintiff; the assessment of the IRS is presumed to be correct. *See e.g., Ruth v. United States,* 823 F.2d 1091, 1093 (7th Cir. 1987); *United States v. Pomponio,* 635 F.2d 293, 298-99 (4th Cir. 1980); *Gold v. United States,* 506 F.Supp. 473, 477 (E.D.N.Y.), *aff'd without opinion,* 671 F.2d 492 (2d Cir. 1981).

The issues presented by this case are relatively straightforward. As the parties recognize, the only contested matters are whether plaintiff was a "responsible" person under the statute, and, if so, whether his non-payment was "willful." There is comparatively little case law on these specific elements in this Circuit, but the standards are uncomplicated and generally well-developed. Evaluation of the evidence presented at trial, in light of the guidance provided by cases from this and other circuits, indicates that the plaintiff has sustained his burden on both of the determinative issues.

1. Responsible Person.

Section 6672 casts a wide net of liability over persons who may be deemed "responsible." Whether a person is responsible depends on his "status, duty and authority" within the corporation. *Mazo v. United States,* 591 F.2d 1151, 1156 (5th Cir.), *cert. denied,* 444 U.S. 842, 100 S.Ct. 82, 62 L.Ed.2d 54 (1979). As the impressive array of cases cited by the government demonstrates, there are significant limitations on what a plaintiff may show to establish that he was not responsible. It is no excuse, for example, that an individual fears losing his job as a consequence of paying the required employment taxes. *See e.g., Howard v. United States,* 711 F.2d 729, 734 (5th Cir. 1983); *Gephart v. United States,* 818 F.2d 469, 475 (6th Cir. 1987). Similarly, proof that an individual was acting at the direction

of a superior does not mean that he or she is not "responsible." *Roth v. United States*, 779 F.2d 1567, 1572 (11th Cir. 1986).

None of the cases cited by the government, however, address the situation presented by this case and this plaintiff, and the unmistakable thrust of the law indicates that this plaintiff was not a responsible person. The touchstone of the responsible person inquiry is "*effective power* to pay." *Howard, supra*, 711 F.2d at 734 (emphasis in original). The test is one of substance, rather than form, and the duty to pay over employment taxes is not absolute, without reference to the reality of the particular situation of the taxpayer and corporation. *Cf. Slodov v. United States*, 436 U.S. 238, 254, 98 S.Ct. 1778, 1788, 56 L.Ed.2d 251 (1978). *See also Godfrey v. United States*, 748 F.2d 1568, 1576 (Fed. Cir. 1984); *Drummy v. United States*, 84-1 U.S. Tax Cas., CCH ¶ 9105 (D.Mass. 1984). A cursory examination of plaintiff's position during the period following the third week of 1981 reveals that he had nothing approaching the requisite power.

It is certainly true, as the goverment argues, that the Safelon corporation had a duty to cease operations in order to avoid generating additional tax liabilities. *See Thibodeau v. United States*, 828 F.2d 1499, 1506 (11th Cir. 1987) ("the government cannot be made an unwilling partner in a business experiencing financial difficulties"). In *Thibodeau*, the taxpayer argued that it was necessary for him to sign certain checks in order for him to keep the business operating as a going concern, and the failure to pay the employment taxes was therefore justified. Plaintiff makes no such argument here. It is abundantly clear that Hochstein *himself* had no power to cease Safelon's operations, no power to fire the remaining supervisor employees, or any input into the decision to continue processing Safelon's supplies on hand.

Appendix F

Hochstein found himself in a position of having insufficient funds from Rosenthal, *no* independent funds from Safelon, and already-generated tax and wage liabilities. He was powerless to do anything other than what he did, namely, to sign over the checks for the wage funds. Plaintiff's status, duty and authority within the Safelon corporation distinguish him from those cases where individual tax liability has been found, and compel a conclusion that he was not "responsible" under § 6672.

2. Willfulness.

If, contrary to the Court's conclusion, Hochstein were in fact a responsible person under § 6672, his failure to make the required payments would also have to be "willful" for liability to exist. The standards for the required willfulness are well established:

> A responsible person is liable under section 6672 only if he or she "wilfully" fails to ensure that withholding taxes are paid. Wilfulness requires merely a voluntary, conscious and intentional act; a bad motive or evil intent is not necessary. *Mazo v. United States,* 591 F.2d 1151, 1154 (5th Cir.), *cert. denied,* 444 U.S. 842 [100 S.Ct. 82, 62 L.Ed.2d 54] (1979). A considered decision not to pay the taxes owed, evidenced by payments to other creditors with knowledge that withholding taxes are due, establishes willfulness.

Wood v. United States, 808 F.2d 411, 415 (5th Cir. 1987). *See also Ruth v. United States,* 823 F.2d 1091, 1094-95 (7th Cir. 1987); *Kalb v. United States,* 505 F.2d 506, 511 (2d Cir. 1974).

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The willfulness requirement is satisfied where the responsible person made the conscious and deliberate choice to pay other creditors instead of paying the government. *Spivak v. United States,* 370 F.2d 612 (2d Cir.), *cert. denied,* 387 U.S. 908, 87 S.Ct. 1690, 18 L.Ed.2d 625 (1967). There is, however, some element of personal fault; "[t]he fact that the provision imposes a 'penalty' and is violated only be a 'wilful failure' is itself strong evidence that it was not intended to impose liability without personal fault." *Slodov v. United States,* 436 U.S. 238, 254, 98 S.Ct. 1778, 56 L.Ed.2d 251 (1978).

As indicated by the factual findings and the discussion above, there is no evidence of significant payments to other creditors, and it is clear that Hochstein did not give priority to other business obligations of Safelon, over the liability to the I.R.S.[6] It is apparent that when the funds were available, Hochstein made the required payments. Plaintiff has met his burden of establishing that, even if he was a responsible person, he did not act willfully. Accordingly, plaintiff cannot be liable for the assessment.

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6. The government cites *Collins v. United States,* 848 F.2d 740 (6th Cir. 1988) for the proposition that payment of employee wages must be subjugated to payment of taxes. In that case, the taxpayer paid wages *and* company expenses in lieu of employment taxes, "as a matter of sound business judgment . . . in order to keep the corporation operating as a going concern." *Id.* at 741. Also, on the evidence in that case, "it was undisputed that [plaintiff] was the person responsible," and that he "voluntarily, consciously, and intentionally paid other creditors rather than paying over the withheld taxes." *Id.* at 742.

Collins merely reiterates the established standards set out above, and does not create a special definition of responsibility or willfulness which would include the plaintiff in this case.

Appendix F

CONCLUSION

Judgment will be entered for plaintiff on the amounts paid by him under the individual § 6672 assessment, with interest. The counter-claim of the government is denied, the remainder of the assessment is abated and the government is enjoined from taking further steps to recover the Safelon employment taxes from plaintiff.

Plaintiff will prepare and submit a judgment, in proper form for signature, to the Judgment Clerk of this Court by June 9, 1989.

SO ORDERED